TAX LEGISLATION 1980

SUBMISSION TO

THE MINISTER OF FINANCE

AND

THE MINISTER OF NATIONAL REVENUE

SPRING, 1980

THE CANADIAN CHAMBER OF COMMERCE

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FOREWORD

In a letter dated March 27th, 1980, to the Minister of Finance, the Canadian Chamber of Commerce set out its views on the Canadian economy and the appropriate stance for federal fiscal and monetary policies. While the memorandum presented primarily an economic analysis of the relevant issues, it also contained general guidelines with respect to taxation policy. The purpose of this submission is to elaborate on the recommendations contained in that letter, and to make further recommendations in specific areas of tax policy.

It is important that the recommendations in this submission be read in the context of the March 27th, 1980 letter, wherein the Chamber recommended that the first priority be given to control of inflation in Canada. Consistent with this objective, the Chamber recognizes the severe revenue constraints facing the government in preparing tax changes at this time and acknowledges that it will be necessary to defer implementation of several of the proposals presented herein until they can be afforded.

INTRODUCTION

Stability to Promote Growth

Last year at about this time, we recommended that priority be given to the stability of the current tax structure. In our view the system had matured to a point where stability could be given priority. We believe that this objective for the tax system was a necessary condition of a sound environment in which the Canadian private sector could grow, improve its competitive position and continue to provide an increasing number of jobs to employ our expanding labour force.

We continue to hold this view. We believe that the existing Canadian tax structure has merit in many aspects, although it continues to require timely changes which will always be essential to a good tax system. The purpose of the balance of this brief is to suggest specific areas in which changes should be considered. Nevertheless, we believe the magnitude of change should be reduced from the levels we have experienced almost every year during the 1970's. Proposed tax changes should be relatively limited in number and concerned with areas where obvious inequities have developed or relatively few taxpayers are affected.

Revenue Constraints

We are particularly cognizant of the severe constraints on additional relief to taxpayers and the need to allow the federal government to bring its expenditure growth into line with its revenue growth. While the brief contains a number of recommendations which would reduce government revenues if enacted, we recognize that, as a practical matter, it may be necessary to defer implementation of a number of our suggestions simply because of their impact on government revenues. Nevertheless, we believe it is appropriate to look at tax changes in a long-term context, and we hope that all of our suggestions will be taken into account sooner or later. In addition, a number of our suggestions have limited or insignificant revenue implications. These are changes which would remove specific inequities, reduce complexity or improve taxpayer compliance and the administration of the tax system. These are changes we believe could be considered sooner, rather than later, within the two general constraints set out above.

Use of Tax Incentives

We would like to reiterate the general comments we made last year with respect to the use of the tax system to influence the economic behaviour of Canadians. We believe that the tax system can be used to influence economic behaviour. However, we believe that the government has shown a tendency over the years to misuse the tax system in this regard. In particular, we believe that the use of a tax system to provide short-term influences on economic behaviour is generally inappropriate. To be effective, economic tax incentives must be designed to promote fundamental and long-term economic objectives. Tax incentives which are temporary or too meagre tend not to affect decision-making so that tax reductions therefrom tend to be windfalls

rather than rewards for behaving in a desired way. The employment tax credit scheme is an example of a poor incentive. Similarly, the weakening of the investment tax credit, through its reduction of depreciation or expense claims, is an example of a tax incentive which is generally ineffective because it is meagre. On the other hand, the low rates of tax for manufacturing and processing and the fast write-offs for manufacturing and processing and the fast write-offs for manufacturing and processing capital equipment are, we believe, effective incentives consistent with our long-term economic goals. Similarly, scientific research incentives are moving in the right direction although, as commented on later in the brief, we believe there are a number of improvements that could be made in this area.

In each of the following sections of the brief we have attempted to indicate our priorities by the order in which they are discussed in the section, running from highest to lowest priorities.

BUSINESS AND PROPERTY INCOME

Inflation and Taxation

With double-digit inflation back again, the Chamber is more concerned than ever about the effect of inflation on the income of a business subject to tax. These illusory profits that are being taxed under our current legislation are bringing the real tax rate of a business to levels far exceeding the traditional 50% normal rate and 25% small business rate. As the the Chamber has previously pointed out, awaiting the accounting profession's conclusions on inflation accounting is not practical. Their solutions may be a long time in coming.

The matter of inflation accounting, or inflation adjusting for tax purposes, is very complex and requires serious study by Finance and National Revenue, as well as other public and private sector bodies. In the meantime, the Chamber reiterates its past position that increases be provided to the 3% inventory allowance to bring the allowance more closely into line with current rates of inflation, and to develop a system of indexing of capital cost for tax depreciation purposes. While these are only bridging solutions, they are necessary as soon as possible to provide some relief against the hardship which inflation imposes on the taxation of inflationary profits.

Accounting Concepts

A general movement toward accounting principles in taxation is believed to be beneficial by the Chamber. We also recognize the need to codify the principles which may otherwise be ambiguous. There are two areas which should be considered in this light; namely, prepaid expenses and warranty (special) reserves.

The Finance Minister's economic statement of April 21, 1980, proposes a change in practice dealing with prepaid expenses. Prepaids from December 12, 1979, would be deemed to be amortized over the period of the prepaid expense similar to generally accepted accounting practice.

In the same vein, no action was taken though to permit a deduction for warranty reserves and other special reserves. To properly reflect the income of a company one cannot ignore the reasonable charge to income for warranties which will have to be honoured in relation to the income earned in the period. We recommend that such warranty reserves be permitted as deductions against income under generally accepted accounting principles.

Depreciable Property

The prohibition on the use of capital cost allowance on leased moveable property to shelter non-leasing income is inconsistent with tax shelters available for Canadian films and oil and gas properties. We recommend this limitation on capital cost allowance with respect to leased moveable property be removed.

In conjunction with leasing, there are indications that effective use of the investment tax credit available to lessors is not being achieved. As leasing becomes a major financing method, we believe the full benefits of the investment tax credit should be permitted to be realized. We recommend that the credit should be transferable on all but short term leases as agreed upon by the lessor and lessee which would be binding on the parties.

Instalment Accounting

There are a number of circumstances which give rise to instalment sales. The Income Tax Act recognizes a number of these transactions and permits the incident of taxation to match with the cash proceeds.

The Chamber recommends this matching treatment of instalment sales for tax purposes and advocates that it should be applied uniformly on all instalment transactions; notably, in the following two examples:

a) Where recaptured depreciation arises from the sale of depreciable property and the proceeds of sale are deferred. A reserve under paragraph 20(1)(n) should be allowed. There is no reason to assess tax on the sale of depreciable property in a manner different from tax on the sale of other property.

b) Where goodwill or other eligible capital property has been sold under deferred payment terms, a reserve should also be allowed under paragraph 20(1)(n) to permit tax to be paid in the year proceeds are received.

"Earn-Outs"

There are many commercial transactions which involve the sale of a business, whether it be shares of a company or the underlying assets, on an "earn-out" formula whereby the ultimate sale price relates to the ongoing profitability or other conditions which are not crystallized until a future date. Where the sale is of assets, the reserve provision set out under our discussion on instalment accounting above will be appropriate.

We believe the Act should contain specific rules which permit the return of capital invested prior to any taxation on gains anticipated by the "earn-out" formula on a share sale. Interpretation Bulletin IT-426 sets out guideline rules appropriate for share sales which could be adopted for "earn-out" sales. These rules though should be included in the Act itself.

Non-Capital Losses

We believe that the present rules should be amended to allow a carryback of three years and a more generous carryforward time limit so long as beneficial ownership does not change.

Valuation Fees

A deduction should be allowed for the cost of valuing capital property in order to report capital gains. At present, these costs are only allowed when they are incurred in respect of an objection or an appeal from an income tax assessment. Logically, it would be in the interest of better tax administration if valuations were encouraged before filing returns so that the costs of dealing with objections and appeals would be minimized.

Guarantees

Since the fees received by a guarantor must be included in income, a guarantee should be treated as capital property, and any outlay by the guarantor should be allowed as a capital loss, and any recovery by the guarantor should be treated as a capital gain. Interpretation Bulletin IT-239-R provides that a shareholder or partner who lends to his corporation or partnership at no interest will be allowed a capital loss on any subsequent loss on the loan or guarantee provided certain business tests are met. We recommend that this interpretation be given statutory sanction.

Section 74(3) and (4):
Remuneration Received As Employee Of Spouse

The Finance Minister's April 21, 1980 statement finally recognized our objection to the penalty imposed on unincorporated businesses in not permitting a deduction for remuneration paid to a spouse. We welcome this proposal.

Section 20(1)(c):
Deductibility of Interest

Paragraph 20(1)(c) presently allows a deduction for interest on money expended to purchase capital property only if income may be derived from the property. Interpretation Bulletin IT-239-R permits a shareholder or partner to deduct interest on money which he has borrowed to relend to his corporation or partnership at no interest providing the corporation or partnership uses the proceeds for the purpose of earning income from a business or property. We agree that such interest should be deductible to the share-

holder or partner but believe that for greater certainty, this pronouncement in IT-239-R should be given statutory sanction.

Section 20(1)(f):
Discount on Certain Obligations

Section 20(1)(f) permits a discount to be deducted from income only at the time when the obligation is redeemed. Under the pre-1972 Income Tax Act, only financial companies were permitted such a deduction, and the deduction was permitted on an amortized basis over the life of the obligation. Although subparagraph 20(1)(f) provides a deduction not previously permitted ordinary companies, it penalizes financial companies which now must await the redemption of the obligation before obtaining a deduction. Therefore, the Chamber urges that the deduction of discount on obligations on an amortized basis be restored for financial companies, effective January 1, 1972. It is suggested that the repeal of subparagraph 18(1)(f) would permit finance companies to claim bond discount on an amortized basis.

Section 80:
Debtor's Gain On Settlement Of Debt

As presently worded, Section 80 is completely arbitrary and can result in unfair situations. For example, debt may be incurred to acquire capital property such as shares, and a subsequent forgiveness may be applied to reduce a non-capital loss carryforward. We recommend that the arbitrary order of reductions be replaced by a rule that would attribute the gain on settlement of debt first as a reduction of any cost in property acquired from the proceeds of that debt, secondly as a capital gain if no attribution to particular capital property could reasonably be made, and thirdly only one-half of the gain should be attributable as a reduction in the cost of non-capital depreciable property.

INCENTIVES

We referred earlier to the risk that certain tax incentives may be ineffective and even harmful to the economy.

Over the years, the government has introduced some incentives that have been either meagre or too temporary (or both) to significantly affect decision-making. The more temporary the incentive, the larger it must be to elicit the desired response. Even very significant incentives such as certain statutory tax shelters show a significant time lag between legislation and marketplace effect. Because of these constraints, incentives should be restricted to those which can remain in force indefinitely in order to promote fundamental and long-term economic objectives. Meagre or temporary incentives tend not to affect decision-making and the tax reductions therefrom tend to be windfalls rather than rewards for behaving in the desired way.

There is a risk that an incentive may attempt too much. One can imagine an incentive that might be powerful enough to induce a taxpayer to embark on a venture that is fundamentally uneconomic. In such a case, it might well be

that the taxpayer would be protected from loss only at the expense of other Canadians.

There is a further risk associated with incentives. The impact of a well-intentioned incentive may be greatly reduced if it is perceived by the intended beneficiaries as an attempt to increase the degree of government control over their affairs - i.e., as evidence of further statism. This risk increases in proportion to the complexity of an incentive and the regulations it entails.

We fear that the temporary employment tax credit may constitute undue tinkering with the economy. We suspect that there are better ways of shaping a stable tax system that will promote fundamental economic objectives over the long-term. Restricting the credit to jobs that would ordinarily be ruled out on non-tax grounds brings into question the basic soundness of the incentive. Its effectiveness is further limited by regulations and complexities. The employer must make the rather subjective declaration that the job would not have been created without the incentive. The government reserves the right to terminate the credit for any particular job at any time, if, in the opinion of the government, the job is no longer considered acceptable for credit. The incentive involves a considerable amount of regulatory jargon (terms such as notice of hiring, normal work weeks, eligible employer, fluctuating and non-fluctuating places of business). People running businesses already feel that too much of their time and energy is devoted to coping with government. An incentive should not impose restriction, paperwork and unfamiliar rules and definitions on the beneficiary in his day-to-day operations.

While having reservations about the employment tax credit, we do endorse a number of other tax incentives - the small business credit, the manufacturing and processing credit, the investment tax credit, scientific research incentives, special rules for farmers and fishermen, special rules for resource industries and others. One reason that we favour these incentives is that they are relatively permanent and can promote fundamental economic objectives in a stable way. Another reason is that they do not involve undue complexity or bureaucratic interference in the operation of a business. (This is not to say that they are necessarily simple. The manufacturing and processing credit for example, is a detailed calculation based on many pages of rules and regulations under the Act. But this complexity is routinely handled by accountants in the course of tax return preparation. It does not inconvenience the business manager.)

We welcome the repeal of the requirement that investments must be made before July 1, 1980 to qualify for the investment tax credit. This should make the incentive much more relevant to long-term capital budgeting by businesses. The incentive would be even more effective if the five-year carryforward limit was extended and, if the portion of tax otherwise payable in a particular year that the credit may shelter was increased. The incentive is greatly weakened by the requirement to reduce the tax cost of depreciable property (or the amount of scientific research expense as the case may be) in respect of the credit. But, this also results from the psychological impact (now you get it, now you don't) on businessmen. Moreover, the circular calculation that arises when the level of tax in a year is not high enough to fully use the credit is too complex. Simultaneous equations may have to be

used to compute the maximum credit. Investment tax credits arising from scientific research must be included in taxable income whether or not the credit is ever actually realized. This anomaly should be corrected.

Research and Development

The budget speech of December 11, 1979 stated that a study is to be made of the rather complex tax incentives for research and development which have only recently been legislated. This reviewing of R and D incentives, with a view to achieving an improved performance by Canadian businesses, is long overdue. The matter is vitally important; our future growth is heavily dependent on how we handle this issue. We must meet strong international competition for research projects from other countries with powerful research advantages. To be fully competitive, our industry needs the advantage of up-to-date technology adapted to Canadian needs and closely tied to existing industrial plants. It is imperative that the study be completed quickly and that desirable reforms be put in place without delay.

The Chamber recognizes the advances in this area made recently and the value of the present incentives, such as:-

i) the ability to write-off the cost of capital research facilities 100% in the year they are made,

ii) the additional 50% deduction for R and D expenditures that exceed average expenditures on R and D for the previous three years,

iii) the 10% investment tax credit for R and D available to most businesses,

iv) the 20% investment tax credit for R and D in the Atlantic provinces and the Gaspé, and

v) the 25% investment tax credit for R and D by small Canadian-controlled private corporations.

However, we believe that in the light of the reportedly low Canadian level of R and D expenditures as a percentage of gross national product and especially so in the key industrial sector, the attractiveness of risk expenditures in R and D projects should be improved and that the government's contribution should be increased--especially toward steady on-going research programs. We therefore recommend that:-

a) The investment tax credit of 10%, 20%, or 25% as the case may be, be exempt from income tax, i.e., not reduce the section 37 deduction.

The investment tax credit incentive is greatly weakened by the requirement to reduce the deductible amount of scientific research expense by the amount of the credit. The weakening results in part from the obvious dilution of the incentive. But it also results from the psychological impact (now you get it, now you don't) on businessmen. Moreover, the circular calculation that arises when the level of tax in a year is not high enough to fully use the credit is too complex. Simultaneous equations may have to be used to compute the maximum credit. Invest-

ment tax credits arising from scientific research must be included in taxable income whether or not the credit is ever actually realized. This anomaly should be corrected.

The reduction mechanism masks the fact that the benefit of the credit is only about one-half its nominal amount. If the government only wishes to give a 5% credit for R and D, it should do so openly rather than in a concealed, complicated and confusing manner. Furthermore, reducing the credit to its true value and leaving the deductible amount of R and D undiminished would share the revenue cost of the tax credit more equitably with the provinces.

b) The assistance for capital projects under section 37.1 be separate and, in addition to that for current expenses, as was the case under IRDIA.

The IRDIA definitions of special purpose equipment and general purpose equipment were, on the whole, understandable and satisfactory and could be used for income tax purposes in this area.

The problem with the present combination of capital and current expenditures is that if a taxpayer acquires a laboratory or some other expensive item of research capital equipment, he will get no further credits for the next three years even if his current research effort is increasing.

c) The additional deduction under section 37.1 for additional (current) expenditures should be on the excess over 75% of the expenditure base of the corporation instead of 100% as at present.

This would contribute toward on-going research and recognize the fact that an on-going, large scale research program generally consists of a number of projects of various sizes and lengths. As time goes by, individual projects are completed and unless new ones can be justified, the total effort will diminish. The 75% provision would help to encourage the continual process of finding and justifying new projects.

d) The taxpayer should have the right to have the determination of whether a particular activity he undertakes is or is not scientific research referred to the appropriate federal department or agency. He should have the right to make his own submission to that body.

The administration of the definition of Scientific Research in regulation XXIX can cause some problems due to the auditing, accounting and legal approach and training of many people in the Department of National Revenue rather than a scientific approach and training.

We have no quarrel with the definition itself as set out in Part XXIX. It seems to be a very good one. It was also used under the IRDIA program and interpreted by the IRDIA program office and the other government departments involved in that program. On the whole, we believe that the IRDIA interpretation and administration was knowledgeable and fair. We believe that this was largely because the involved personnel were scientists or sensitive to scientific and research concepts.

National Revenue apparently recognizes the potential for problems here by the existence of the procedures for consultation with other federal departments and agencies which are outlined in paragraphs 19 and 20 of Interpretation Bulletin IT-439 of September 17, 1979. Unfortunately, however, these procedures only seem to apply when the taxpayer has requested an advance ruling. This consultation with other federal departments and agencies does not appear to be a part of the normal assessing process. It should be such a part.

The taxpayer has no assurance that where he has been assessed adversely, his case has been ruled on by a knowledgeable scientific agency. We therefore recommend that when Revenue Canada disputes whether a particular activity of the taxpayer is truly scientific research, the taxpayer should have full opportunity to put the case to the appropriate department or agency as a matter of the taxpayer's right to an adverse assessment or a confirmation under section 165(3).

e) The full benefit to the Canadian economy from local research and development activity is realized when the project enters into commercial production in Canada. Employment and further capital equipment investment factors are realized at this point in the process.

The definition of 'Development' provided in IT Bulletin No. 439 does not fully recognize the various work elements that are an essential part of the Scientific Research and Development activity leading to the commercial production process.

The following amendments are proposed in order to recognize the contribution these functions make to the R & D process.

The bulletin recognizes the eligiblity of pilot plant operations, but excludes, under Paragraph 13, the costs of trial production runs which represent a critical stage in new product development. The exclusion appears in conflict with Paragraph 9, which states: "If the primary objective is to make further technical improvements on the product or process, then the work comes within the definition of development." The pilot production or trial production run represents a critical stage in the new product development process. Commercial production does not begin until the results of this stage have been evaluated and accepted.

We recommend that the definitions provided in Paragraph 9 be expanded to include trial production runs as an allowable element under the definition of development. This inclusion would negate Paragraph 13, which would be deleted from the bulletin.

The definition of data collection related to scientific research under Paragraph 18 of IT Bulletin No. 439 should be expanded to recognize the contribution made to new product development through the collection of warranty and field performance data. Research analysis of this data is a critical part of any new product development process. We recommend that warranty and field performance data be included for eligibility under the Scientific Research Data Collection Section.

f) We recommend that the various Scientific Research Tax Incentives be made available to individuals. The present restriction limiting them to incorporated businesses should be removed. Further, we believe that it would be possible to modify the research incentives so that individual investors in the public could participate in a form of research tax shelter, which would be similar to tax shelters such as the oil and gas shelter. We believe that these extensions of the research incentives to individuals would not only promote a greater flow of funds to scientific research but would also serve to increase the general public awareness of research activities and the importance of them to our economic development.

g) There is also an anomaly in Section 37.1 (the additional allowance) which is causing some problems. In subsection 37.1(1) the additional allowance is availabe "in computing the income for the taxation year of a corporation that carried on business in Canada". In some situations, research and development activities are carried on in partnerships where all the partners are corporations, and it is the present view of Revenue Canada that the additional allowance is not available in these circumstances. In the Chamber's view, it would be logical to extend the allowance to research and development activities carried on in partnership where all the partners are corporations.

ENERGY AND MINERAL RESOURCES

The Chamber believes the steps proposed in the two 1978 Budgets of April 10th and November 16th, will be constructive.

These include:

(1) resorting the immediate deductibility of mine development expenses;

(2) continuing until December 31, 1981 the immediate deduction of Canadian Exploration Expenses (including mine development expense) by individuals and non-resource corporations;

(3) allowing the capital cost of social assets and townsite facilities for new mines to earn depletion on a $1.00 for $3.00 basis;

(4) including the costs of completing and recompleting producing oil or gas wells in the definition of Canadian Development Expense so that these costs earn depletion and will not reduce the resource allowance;

(5) granting depletion at the rate of $1.00 for $2.00 on the cost of machinery, equipment and other facilities acquired for enhanced recovery systems of petroleum;

(6) allowing the depletion earned through investment in non-conventional oil projects, bituminous sands mining projects and enhanced recovery systems for petroleum to be deducted up to the extent of 50% of total income, and

(7) increasing the rates of the investment tax credit while continuing to recognize regional disparities.

The Chamber also welcomes the report of the Finance and Resource Ministers' committee which reviewed the tax situation in mining. It appears that this report could be a most useful basis for future government action. The Chamber also appreciates the statement in the November 16th Budget that benefits from tax reductions that provinces may introduce will not be offset at the federal level.

The Chamber believes that Canada's economic growth is dependent, to a significant degree, on the discovery of new mineral deposits and the continual renewal of ore reserves; it continues to support the goal of achieving the highest level of Canadian energy self-sufficiency that is economically possible. The Chamber perceives that serious fiscal problems remain which cause difficulties for the discoverer/developer of new deposits.

The Chamber appreciates the worth of the Frontier Exploration Allowance which was a part of the March 31, 1977 Budget. It agrees that a further knowledge of Canada's petroleum and natural gas production potential is essential, particularly in the frontier areas and the deep waters thereof. Unfortunately, the Budget of December 11, 1979 proposed the virtual elimination of this provision, i.e. a 90% reduction from 66-2/3% to 6-2/3%. While we appreciate the very legitimate concerns expressed at that time, that for high income individuals the 66-2/3% allowance was too great and reduced the incentive to efficiency in exploration costs, we do think the cure was overly dramatic. In effect, the baby was thrown out with the bath water! Without recommending any particular rate, or rates, the Chamber suggests that the allowance be, in effect, reinstated at a substantial figure for a further five-year period.

To overcome the problem of high income individuals, we suggest that there might be two rates of some substance - one for individuals and one for corporations.

The following specific proposals are recommended for co-operative action with all of the provinces:

(1) to support mineral exploration and development by the private sector through a system of income tax relief and through restraint in the use of the tax and royalty systems;

(2) to ensure that the effect of combined taxes and royalties of both levels of government will not result in total levies that are unreasonable to the degree that they serve to discourage investment in the industry and result in decreased levels of exploration and development;

(3) to provide specific assurances of stability of policy;

(4) to establish fiscal terms for the high cost oil sands, heavy oil, uranium and other massive developments which will provide a return to developers, commensurate with the risks taken;

(5) to reinstate the Frontier Exploration Allowance for a further five-year period at whatever substantial rate or rates are deemed appropriate and to consider whether similar encouragement could be given to other energy development activities.

CAPITAL GAINS

The Chamber recognizes that changes have been made to the capital gains tax over the years for the purpose of reducing or eliminating some of its inequitable and economically harmful features. However, defects remain and the Chamber recommends that the capital gains tax provisions be further liberalized so as to enhance the equity of the tax and reduce its adverse effects on investment decisions. We have identified two general types of changes which should be considered:

1. Inflation and the Computation of Capital Gains

In recent years, the capital gains tax has been levied during a period of rapid inflation that was beyond contemplation at the time the measure was introduced. During the 1970's, the Consumer Price Index doubled. As a result, a large part of the capital gains accrued since the implementation of the 1971 tax reforms is nominal and not real. Indeed, after adjusting for inflation, the real gain may be negative, so that the tax in effect becomes a capital levy which reduces the amount of real capital available for investment.

In our view, the taxation of inflation-induced nominal capital gains is inequitable, for "ability to pay" surely implies that taxpayers should be taxed on their real incomes and not on illusory gains.

We recommend that for purposes of computing capital gains, the cost of capital property should be indexed to the rate of inflation during the holding period. While from the point of view of equity, this indexing should be equally applicable to the computation of capital losses, we believe that the exposure to substantial revenue loss which such a measure entails would not be tolerable and therefore recommend indexing only for the purpose of computing capital gains and not capital losses.

2. Deductibility of Capital Losses

Another principal defect in the current capital gains tax is the limited deductibility of capital losses from other forms of income. For one thing, it is inequitable to tax capital gains as they are incurred and not allow a current deduction for allowable capital losses. This point was recognized and responded to by the Government, particularly by the introduction in 1978 of measures to permit allowable capital losses sustained on certain investments in Canadian-controlled private corporations to be deducted from other income in the same manner as business losses.

Also, the limits on deductibility constitute a serious disincentive for risk-taking. An investor, knowing that he cannot set off his capital losses against other income, is likely to have greater concern about potential losses and take a cautious attitude toward risky ventures. Certain tax measures have recently been enacted or proposed by certain provinces for the purpose of stimulating the flow of venture capital. We suggest however, that liberalizing the deductibility of capital losses would help to further stimulate the flow of venture capital.

We recognize that, since timing the recognition of capital gains and losses is largely in the hands of the investor, the prospect of substantial revenue loss militates against allowing the full deduction of capital losses against other income. However, the Chamber recommends that consideration be given to extending the right to deduct allowable capital losses from other income. For example, allowable capital losses might be made deductible from income which would otherwise be fully taxable on the sale of business assets (i.e. recaptured depreciation and eligible capital amounts).

Consideration should also be given to extending the right to carry-back a deduction for allowable capital losses against prior years' taxable capital gains (and $2,000 of other income) from one year to three.

3. Canadian Common Stock Investment Plan and Registered Retirement Savings Plan

As stated in its pre-budget submission last August, the Chamber strongly encourages the implementaion of a concept like the "Canadian Common Stock Investment Plan" which was contained in the December 11, 1979 federal budget, but not introduced April 21. Such a plan would encourage investment in Canadian equities. Specifically, the Chamber considers that the contribution levels of $20,000 for 1980 and up to $10,000 per subsequent year to a maximum of $100,000 represents a satisfactory balance between encouraging Canadians to invest in Canadian equities and mitigates against a significant revenue loss.

The Chamber also endorses the December 11, 1979 budget's proposal to allow one-half of dividends received from Canadian public corporations and capital gains from dispositions of shares of Canadian public corporations realized by registered retirement savings plans to retain their non-taxable character in the hands of the planholder, and would encourage further consideration of this proposal.

4. Other Recommendations for Change Section 48: Departure Tax

The exemption from the taxation of capital gains on emigration from Canada, the "departure tax", is $5,000. We believe that this amount is too low and serves to inhibit the free movement of individuals engaged in international business. While the exemption indicates that the Government recognizes the problem, the remedy appears to be insufficient.

The Chamber recommends that, in light of the rapid rate of inflation in recent years, the exemption be increased to $25,000 and, further, that property owned by an individual at the time he became a resident of Canada or, which he inherited while resident be excluded from the scope of the tax if the individual was resident in Canada for 60 months or less during the ten years preceding his departure.

Subparagraph 40(2)(a)(i):
Loss of Reserve

At present, if a taxpayer leaves Canada in a particular year, he retroactively loses his entitlement to deduct a reserve that he may have claimed in the preceding year. We feel this is unnecessarily harsh. This subparagraph should be revised so as to apply only to the year in which the taxpayer ceases to reside in Canada and subsequent years.

Section 42: Honouring Warranties

Although consideration received for giving warranties in connection with the disposition of capital property is included in the vendor's proceeds of disposition in the year the property is sold, an amount expended in the six following years to honour a warranty constitutes a capital loss in the year expended. This may provide the vendor with no practical reduction in tax, since he may have no (or insufficient) capital gains against which to offset the loss. We recommend that the capital loss be allowed to be carried back to the year of disposition (in a manner similar to that employed in subsections 49(3) and (4) where an option is exercised in a year following the year in which it is granted).

Alleviation for Excessive Elections

The Chamber endorses the concept contained in the December 11, 1979 federal budget, and re-introduced April 21, providing alleviation for excessive elections made in the course of distributing pre-1972 surpluses, where the excessive elections triggered capital gains as a result of the adjusted cost base of shares being reduced below nil.

INTERNATIONAL INCOME

Tax Treaties

The Chamber again wishes to emphasize the point that neither Canada nor Canadian taxpayers can possibly benefit when treaty negotiations are conducted under such an air of secrecy.

The Department of Finance must have received a large number of submissions when the negotiations with the U.S.A., for example, were announced. However, we wonder how many of those submissions have been updated to reflect changing circumstances evolving during the years of negotiation.

We believe that unless the Department of Finance actively pursues a policy of encouraging a dialogue between those officials responsible for negotiating our treaties and representatives of relevant sections of the community, Canada fails to optimize the opportunities available. It is ironic that details of some of Canada's tax treaties become known via the other party which must have no illusions about its role!

Apparently negotiations with some countries have been "put to the bottom of the pile". This we find unacceptable. The basis of the revised philosophy of taxing foreign income in the early seventies was that Canada would negotiate a "full" network of treaties.

We submit that the task of completing that work become a priority task of the Department of Finance.

Furthermore, in those instances where negotiations have commenced and the other party is still not included in the list of prescribed countries (Regulations 5907(11)) we recommend that this anomaly be speedily rectified. We should add that we did note with satisfaction that Argentina and Cyprus were recently added to that list, but the status of others does leave unnecessary uncertainty for many Canadian companies.

We have also previously suggested that consideration might be given to holding hearings on tax treaty negotiations during which the Canadian position on specific issues would be explained and interested parties given an opportunity to comment on the developments in negotiations. We believe that this would give Canada's negotiators a better understanding of the objectives of Canadian taxpayers while also helping to ensure that unwarranted concessions are not being made.

Competent Authority Proceedings

The Chamber is disappointed that the former Minister of Revenue did not respond to our comments last year. We are seeing evidence of an ever-increasing tendency of Canada/U.S. questions in particular being submitted to the respective competent authorities.

We wish to emphasize that when it is perceived that there is a "give and take" procedure to clear many cases, the Canadian taxpayer must be given an opportunity to be a party to the process.

The Chamber will be happy to assist the new Minister in a common endeavour to maximize the strength of the Canadian case.

Foreign Affiliate Rules

The Chamber restricts its observations in this area to those which appear to affect our members most frequently:-

1. There should be a right of offset when FAPI gains arise in one affiliate and losses occur in another.

2. Furthermore, a Canadian taxpayer should be entitled to offset allowable capital losses against taxable capital gains included in FAPI.

3. We remain unconvinced that the administrative problems associated with obtaining an authorizing director's resolution under the Section 93(1) procedure is necessary and recommend its repeal.

4. The possibility of losing surplus balances as a result of reorganization by wind-up and merger or amalgamation of a group including one or more foreign affiliates is an unnecessary complication and indeed potential penalty to a Canadian multinational and amendments should be made to remove these obstacles.

CORPORATIONS

The Canadian Chamber of Commerce had hoped that the extensive amendments to the Income Tax Act introduced during 1977, which revised significantly the taxation of corporations and their shareholders, would remain substantially unchanged for a significant length of time. Regrettably, however, we have seen major changes introduced in the November 1978 budget, intended to restrict the availability of the small business deduction, and these changes introduced significant new complexities. Subsequently, the December 1979 budget and the April 21st statement, introduced two further proposals (in the areas of corporate partnerships and the so-called "capital gains strips") which the Chamber views as over-reactions which will cause complexities out of proportion to any benefit derived by the taxation authorities.

Corporate Partnerships and the Small Business Tax Rate

Currently, qualifying Canadian-controlled private corporations are entitled to the lower Federal tax rate on up to $150,000 of active business income each year. Under the present Act, if a business is organized as a partnership of non-associated corporations, each of the corporate partners is allowed the low rate of tax on up to $150,000 of its share of the partnership business income. In order to eliminate this perceived advantage, the December 1979 budget and the April 21 statement proposed that the $150,000 limit will apply to the total profits of a corporate partnership, and that a corporate partner's share of the benefit will be proportionate to its share of the partnership profits.

In the Chamber's view, the treatment accorded to corporate partnerships under the present law is not offensive, since, by definition, a corporate partnership can gain an advantage only when the corporations are not associated. In many industries, particularly in the real estate and resource property fields, it is common for corporations to carry on business in joint ventures with other corporations. It these joint ventures are held to be partnerships, the difficulties caused in applying the proposed changes would be overwhelming. One corporation might be in a partnership activity with three or four others, and those three or four others might well be in partnership activities with other corporations, and all of those partnership activities

might have different fiscal periods. While professional advisors to the corporate sector will probably appreciate the extra fees generated in applying the new provisions, it is unlikely that the corporate sector would regard this as a useful application of their funds.

At the very least, the Chamber urges that the provision be narrowly defined to include only those areas where taxation authorities are able to identify abuses.

Capital Gains Strips

It is recognized that some action on the part of the government is required to limit tax avoidance in this area. However, the Chamber submits that the proposed changes, at least as far as can be ascertained from the wording of the budget documents, constitute an over-reaction. We would have thought that only slight changes to Section 55 would give the revenue authorities sufficient power to attack cases of abuse. We are encouraged by the comment tht rules will be introduced to ensure the various changes will not affect transactions in the course of bona fide corporate reorganizations, and we hope that these will be broadly defined.

For example, tax advisors (and we had thought tax authorities also) had been greatly heartened by the ability to split off corporate assets into separate corporations using the existing provisions, and we hope that the rules will provide that this will remain possible, provided that assets are not distributed to individual shareholders.

Subsection 248(1) Income Debentures and Term Preferred Shares

In its last submission the Chamber proposed that a corporation qualifying for the small business deduction should be entitled to issue qualfying income debentures or retractable preferred shares. This submission was met by the introduction in the December 1979 budget of the concept of the Small Business Development Bond, which has been reintroduced in the April 21st statement. We commend the government for this action. We are concerned about the very limited time available for putting these Bonds in place. If the present proposal is to be effective, we believe the time limit must be extended significantly.

Consolidated Reporting for Tax Purposes

For a number of years, the Chamber has included in its pre-budget submission a request for a review of the prospects for consolidated reporting for tax purposes of the taxable incomes of members of a common corporate group. The changes introduced by the Federal Government in 1977, including the elimination of the designated surplus provisions and the ability to permit tax losses to flow through on wind-ups of wholly-owned subsidiaries and statutory amalgamations, permit many corporate groups to reorganize their group structure to achieve a position permitting consolidated reporting for tax purposes.

Unfortunately, there continue to be many situations where actual consolidation of corporate operations, to permit consolidated tax reporting, is not feasible. These include situations where small minority interests exist; incorporated joint ventures; groups in which separate companies are required or preferred by regulatory bodies; situations where the segregation of potential risks or known liabilities separate companies are required or preferred by regulatory bodies; situations where the segregation of potential risks or known liabilities necessitate the use of separate companies and doubtless many others. In each of these cases, it is desirable from the point of view of tax equity and neutrality to provide some mechanism(s) of tax consolidation, where actual consolidation by merger cannot be achieved.

The Chamber believes that any mechanism(s) introduced for this purpose must be as simple as possible and must not create unduly complicated new rules. These requirements represent a considerable challenge which has not been well met in the tax systems of other countries such as U.K. or the U.S. Nevertheless, the Chamber is aware of two possible mechanisms which have been studied in some depth and which might do the job in many of the situations requiring relief. Both of these mechanisms are present in the existing Canadian tax system in specific areas, and both seem capable of adaptation to solve the tax consolidation problem without creating complex new rules.

The mechanisms might be referred to as the partnership option and the loss renunciation election.

1) <u>The partnership option</u>: This mechanism would permit an electing corporation to be treated as a partnership of all its shareholders. It would make use of the existing special set of rules for the taxation of partnership income. This mechanism would be most appropriate in wholly-owned situations and in the case of incorporated joint ventures.

2) <u>The loss renunciation election</u>: This would be an extension of the mechanism by which a joint exploration corporation transfers the deductibility of its expenses to its shareholder corporations. This mechanism would permit a transfer of losses only and would be appropriate in wholly-owned groups and control situations. This mechanism would also have to contain some provision, in control situations at least, for compensation payments to protect minority shareholders.

A number of technical problems associated with these mechanisms for consolidated tax reporting disappeared with the 1977 tax changes. The introduction of new tax consolidation measures such as these may be facilitated now that the pre-1972 surpluses have ceased to exist except upon dissolutions.

To permit people to become familiar with the proposals, however, it is suggested that these proposals be introduced well in advance of their effective date.

While the two mechanisms suggested seem relatively straightforward in concept and make use of existing features of the Canadian income tax system, there are undoubtedly tough problems to be solved in ensuring that they will work smoothly and provide the relief intended, without creating new opportunities

for unintended tax avoidance. The Chamber believes that the proposals should be given serious consideration by the Government. If necessary, the proposals might be introduced in stages. For example, the first step might be to permit a partnership option in wholly-owned situations and for incorporated joint ventures. Ultimately, however, the Chamber believes that it would be desirable to provide mechanisms for consolidated reporting for tax purposes in corporate group situations involving companies where there are minority interests.

In the supplementary information appended to the November 16, 1977 budget documents, the point was made, in connection with consolidated tax returns, that significant variations in the rates of federal and provincial taxes on corporate income do exist, which would complicate achieving consolidation at both the federal and provincial levels. In addition, significant constitutional difficulties may be encountered where, for example, a profitable corporation carrying on business through a permanent establishment located in a different province. In order to achieve consolidation at the provincial level, the first-mentioned province would have to be willing to reduce the amount of taxes it would collect as a result of the losses being sustained within the second-mentioned province. If the rules for allocating the consolidated income of a corporate group among various provinces were similar to the rules set forth in section 402 of the Income Tax Regulations, a portion of the taxable income actually earned in the first-mentioned province would be attributed to the second-mentioned province, depending upon the relative amount of gross revenue and salaries and wages attributable to the permanent establishment located in the second-mentioned province compared with the total group's gross revenue, salaries and wages. That would result in the second-mentioned province receiving tax dollars that otherwise would have been received by the first-mentioned province.

In view of the difficulty of obtaining consensus among the provinces on virtually any issue, the Chamber strongly urges the Federal Government to adopt rules implementing tax consolidation among members of a common corporate group independently of the provinces. Since it is contemplated that only corporate groups electing to take advantage of the consolidation option would be required to report on both a consolidated basis (to Revenue Canada) and on an unconsolidated basis (to the various provincial taxing jurisdictions), the inconvenience and duplicate record keeping that would be involved would be kept at a minimum.

As a minimum, in our view, a mechanism ought to be provided enabling the investment tax credit to be allocated within a wholly-owned group of corporations. It is fairly common for capital expenditures to be made in one corporation with little taxable income, either at the current time or projected for the immediate future, while another corporation in the group has taxable income. Logically, the investment tax credit ought to be availalbe against the income tax of the corporation with taxable income, when the investment has been made in another corporation for valid business reasons.

Section 84.1: Anti-Dividend Stripping

Section 84.1, which was introduced in 1977 as the last vestige of the multitude of anti-dividend stripping provisions (apart from Section 247(1)), was

intended to ensure that some tax is collected on effective realizations of pre-1972 corporate surplus.

The emphasis of the provision is to impose a tax directly on the existing owner of shares with underlying pre-1972 undistributed surplus rather than to impose the tax on his successor (cf. the former tax on designated surplus). This is generally a welcome change. Nevertheless, there are unwelcome effects in particular cases. The Chamber believes the application of this section should be reviewed carefully and, as experience develops, refinements should be introduced. In general terms, our experience to date suggests at least three areas of concern.

1. The first is that the penalty imposed by section 84.1, that is the creation of either an immediate capital gain or a loss of adjusted cost base, seems to be much too severe. In general, this penalty will result in an additional tax of up to 30% in situations where corporate ownership is transferred in the offending non-arm's length transactions. This penalty may be contrasted with the position of no tax at all if the shares are sold in the arm's length sale, an effective tax of about 15% if a distribution had been made (in 1978 or earlier) out of undistributed income, or the position of an effective tax of about 8% (at the top marginal rate) where the surplus is paid out after 1978 as a taxable dividend and an off-setting capital loss is realized.

   Perhaps the penalty might be lowered by reducing the capital gain created or the adjusted cost base reduction to 50% of its present amount under section 84.1.

2. There seem likely to be a number of situations in which a taxpayer will stumble unwittingly into the penalty imposed by section 84.1. Taxpayers who receive the proper advice can avoid the penalty by properly arranging their affairs. However, not all taxpayers will be in this happy position. Some consideration might be given to permitting a taxpayer retroactively to elect out of his predicament. This would be possible in cases where the vendor shareholder has taken back shares of the purchaser corporation. Under the election, the paid-up capital of the shares taken back would be reduced by the appropriate amount, thus eliminating the adjusted cost base reduction which would otherwise occur under Section 84.1. If it is not desired to incorporate such an election into the Income Tax Act, an Information Circular could be published stating that Revenue Canada would permit a taxpayer who discovers or is reassessed on the basis that section 84.1 applied to him may, subject to obtaining the consent and co-operation of the purchaser corporation;

   a) cause any non-share consideration which he received for the subject shares to be exchanged for shares of the capital stock of the purchaser corporation having an aggregate paid-up capital equal to the paid-up capital attributable to the subject shares or;

   b) cause the purchaser corporation to reduce the paid-up capital of the shares of its capital stock that were issued to the taxpayer as consideration for the purchase of the subject shares, without making any distribution of assets, to an amount equal to the aggregate paid-up capital attributable to the subject shares.

Section 87: Extension of Amalgamation Rollover to Circumstances where a Shareholder Exercises his Right to Dissent

Paragraph 87(1)(c) of the Income Tax Act provides that, in order for an amalgamation to qualify for rollover treatment, "all of the shareholders (except any predecessor corporation) of the predecessor corporations immediately before the merger receives shares of the capital stock of the new corporation by virtue of the merger..." Subsection 87(a) expands the rollover treatment to include amalgamations between a subsidiary of a particular corporation (the "Parent") and another corporation such that the amalgamated corporation is wholly-owned by the Parent and minority shareholders of the Parent's subsidiary receive shares of the Parent as a result of the amalgamation, rather than shares of the amalgamated corporation.

The Chamber believes that the section 87 rollover should be further expanded to apply to an amalgamation under the provisions of the Canada Business Corporations Act and comparable provincial corporations statues, where one or more shareholders of an amalgamating corporation have exercised their right of dissent. Under section 184 of the Canada Business Corporations Act, for example, a shareholder of an amalgamating corporation may dissent from the shareholders' resolution authorizing an amalgamation and, when the amalgamation becomes effective, the shareholder has the right to be paid by the corporation, the fair value of the shares held by him in respect of which he dissents. A dissenting shareholder may dissent only with respect to all the shares of a particular class held by him. Once a shareholder exercises his right of dissent, he ceases to have any rights as a shareholder except the right to be paid the fair value of his shares. The important point to note, however, is that a dissenting shareholder does not become a shareholder of the amalgamated corporation. That fact alone would appear to render the entire amalgamation in jeopardy of not receiving rollover treatment, because the requirement contained in paragraph 87(1)(c) of the Income Tax Act is not satisfied (i.e. all of the shareholders of each predecessor corporation have not received shares of the capital stock of the new corporation by virtue of the merger). The Chamber submits that rollover treatment should be accorded to any amalgamation in which all of the shareholders of each predecessor corporation (other than any shareholder who exercises his right of dissent under the corporations statute governing the amalgamation) receive shares of the capital stock of the new corporation by virtue of the merger.

Section 88: Rollover on the Transfer from a Wholly-owned Corporation to its Parent

In previous submissions the Chamber suggested that it would be appropriate to permit the rollover provisions of Section 88 to be extended to cover situations where the subsidiary company was 95% owned by the parent company. We were pleased to see a proposal in the December 1979 budget followed in the April 21st statement, that the rules be relaxed to require that the parent own at least 90% of each class of the outstanding shares of the subsidiary.

Section 51: Convertible Properties

Section 51 should extend to conversions where shares of more than one class are received in exchange for convertible property. The adjusted cost base could be attributed to the various classes of shares according to their respective fair market value.

Deemed Dividend on Reduction of Paid-Up Capital of Public Corporation

Where a public corporation reduces its paid-up capital after April 10, 1978, any amount paid by it is deemed to be a dividend by virtue of subsection 84(4.1). However, the taxpayer is also required to reduce the adjusted cost base of the share by virtue of subparagraph 53(2)(a) (ii). This gives rise to double taxation which could easily be avoided by excluding the dividend arising under subsection 84(4.1) from the reduction in subparagraph 53(2)(a)(ii).

Cumulative Deduction Account

Paragraph 125(6)(b) was revised in 1978 to change the definition of the cumulative deduction account. Prior to the change, the CDA was, basically, a running calculation from 1972 to the point in question. The new definition changed the approach so the starting point for any calculation is the amount of the corporation's CDA at the end of the immediately preceding year. This calculation penalizes any corporation which pays qualifying taxable dividends or sustains non-capital losses which would produce a negative amount at the end of any year. Since the starting point cannot be less than zero, this prevents the corporation from deducting amounts that would otherwise have been properly deductible.

The changed definition has begun to cause problems, and we recommend that the section be amended to permit a running calculation from 1972.

PERSONAL TAXATION

In the personal tax area, the Chamber attaches highest priority to maintaining the integrity of the personal marginal rate structure by the indexation of personal exemptions and rate gradation levels, as provided in Section 117.1 of the Income Tax Act. We note again that this measure is a necessary corrective device required to offset the tendency of a "progressive" rate schedule to increase effective tax burdens in time of inflation. This measure, introduced in 1973 effective for the 1974 taxation year, has made a major contribution to the development of a stable taxation system during a period of historically high rates of inflation in Canada. (Indexation has helped preserve the progressivity of the personal tax rate structure. At the same time, it has prevented substantial hidden increases in personal income taxes. In the absence of other changes in the personal tax base and rate structure, indexation ensures that the rate of increase in the aggregate personal tax revenue as a result of inflation will be in line wiht the rate of inflation itself and not

a significantly greater figure. Not only does this measure ensure a more equitable sharing of the burden of inflation between individual taxpayers on the one hand and governments on the other, but it also helps impose some sense of fiscal discipline on the federal government in particular to give it additional impetus to undertake corrective measures).

The Chamber has become increasingly concerned about the divergence between the top personal rates of tax in Canada and the general corporate rate of tax in our country. The Chamber believes this is a most undesirable trend for several reasons. In the first place, as noted in the general commentary above, the Chamber believes that proximity of the top personal rate to the general corporate rate of tax is essential to long run stability of the system. If the divergence between the two becomes too great, there is a strong incentive to take action involving the incorporation of income sources in situations where such action does not otherwise make sense. Second, such differences lead to a lack of horizontal equity, i.e. significant discrepancies between the taxes payable by individuals having different circumstances but essentially the same levels of income. Third, it is reasonably certain that the higher personal rates go above the 50% level, the more significant they become as a disincentive to work. This disincentive operates most frequently to discourage the creative kind of work effort that Canada so desperately needs in its economic development to maintain and, indeed, improve its position in increasingly competitive work markets. It is recognized that much of the increase in the top marginal rates experienced by Canadian taxpayers is attributable to rate increases of provincial governments. Nevertheless, the federal government has contributed somewhat to this trend and we have seen general tax rates increase from the level of 50%, proposed by the Carter Royal Commission, to 60%, proposed in the federal government's own White Paper on Tax Reform, to rates ranging from the low in Alberta of 59.56% to a high in Saskatchewan of 68.07%. The Chamber believes the federal government should take the lead in dealing with this problem by lowering its own top marginal rates.

The Federal Refundable Child Tax Credit

The federal refundable child tax credit was introduced by special resolution and bill outside the normal budgetary process. This measure received very little independent review. Indeed, much of the supporting material was not released to the public until the November 16th, 1978 budget, well after the measure had been reviewed by the House of Commons and passed into law.

This measure should be discontinued. The government had an excellent opportunity to exercise expenditure restraint by modifying a statutory program in a way which would have been politically palatable. A modification of the approach adopted by the Province of Quebec and the United Kingdom might have been implemented by eliminating the income tax exemptions for dependent children and increasing the amount of the family allowance, while leaving it subject to income tax exemptions for dependent children and increasing the amount of the family allowance, while leaving it subject to income tax. The increased family allowance so determined could be an amount established in legislation to be altered from time to time as circumstances warrant and resources permit rather than being automatically indexed. In this way, the benefits of the allowance would be directed more effectively to lower

income families with children in an administratively simple manner without upsetting the progressive personal tax rate structure and at a substantially lower cost to the government (and taxpayers).

The Federal government's new family tax credit scheme will be extremely costly, administratively complex, and difficult for qualifying families to understand. Because of the complexity of the plan, many persons who qualify will not receive the benefit either because they do not know they are eligible or do not fill out the required forms properly. It is clear from the budget estimates for the 1979/80 fiscal year that there will be a substantial increase in the cost of Revenue Canada operations directly attributable to the new program. We wonder how appropriate annual credits are compared to monthly family allowances, particularly for low income families. We wonder how much "discounting" of child tax credits will take place.

The Child Tax Credit is fraught with difficulties that could be eliminated by an alternative plan.

Joint Return Options for Persons Over 65 Years of Age

There are a number of features of the existing income tax structure which both permit and encourage married taxpayers to split their retirement income for tax purposes. Measures such as the right to make contributions to a spousal registered retirement savings plan and the ability to transfer deductions from one spouse to another as provided under section 110.3 are two principal examples. There are others which permit the same results somewhat more indirectly.

The effect of these provisions, particularly for persons aged 65 or over, is to impose a tax on income similar to that which would be provided if the spouses had the option of filing a joint return using rates with brackets twice the size of those for the individual rate table. The existence of a joint return option would greatly simplify the process of filing returns, particularly for older taxpayers. The Chamber recommends that a married couple be permitted the option of filing a joint return each year where one or both of the spouses is aged 65 or over.

Taxation of Group Life Insurance Premiums

Once again, we request that the $25,000. limit in section 6(4) to measure the portion of life insurance which need not be regarded as a taxable benefit in the hands of an employee be substantially increased. We would recommend an increase from the level of $25,000 to $100,000. This would substantially reduce the employer's cost of preparing T-4 forms without causing a material revenue loss.

Individuals Employed Abroad

Until recent times, individuals who left Canada to take employment abroad for a protracted period, perhaps one or two years, were usually regarded by Revenue Canada as relinquishing their status as residents of Canada and so

ceased to be taxable by Canada on their world income. However, in a series of cases decided in the late 1970's, such individuals were held to be taxable as being "ordinarily resident" in Canada. Also, under Revenue Canada's recently announced assessing practice, as set out in Interpretation Bulletin IT-221, Special Release (July 23, 1979) such employees will be regarded as continuing to be Canadian residents. In many circumstances an onerous tax burden will be the result and will make employment on projects abroad less attractive. To illustrate, in some countries the main source of revenue is indirect taxation such as sales tax, which would not be creditable against an employee's Canadian income tax otherwise payable.

We therefore welcome the measure proposed in the statement of April 21, 1980, which would permit an employee employed abroad for a least six months in connection with rendering services on construction, installation agriculture or engineering projects, or in the extractive industries, to exclude from his income otherwise subject to tax in Canada an amount equal to the lesser of $50,000 (on an annual basis) and one-half of the remuneration received from that employment.

Registered Retirement Savings Plans

Transfer of Funds

Section 146(16) of the Income Tax Act permits an annuitant under an R.R.S.P. to switch from one Plan to another without tax consequences. This is a very desirable provision in that it gives flexibility to R.R.S.P. arrangements by recognizing that one R.R.S.P. carrier may periodically perform better or have a better administration or fee structure than others thereby encouraging competition and, where deemed appropriate, permitting annuitants to switch to a better carrier.

One impediment to making such a switch, however, occurs in the case of self-administered plans where Plan funds are invested in securities selected by the annuitant who may not want to liquidate the same even for the purpose of switching to another carrier. The requirement to liquidate such securities derives from Parliament's limiting transfers to "funds" under R.R.S.P. in section 146(16).

As the revenue would not be affected by broadening the flexibility of this section by permitting the transfer of qualified investments as well as funds held by a self-administered R.R.S.P., we therefore recommend that section 146(16) be amended to permit the transfer of "qualified investments and funds" from one self-administered R.R.S.P. to another such self-administered plan.

Pension and Other Retirement Income Plans

The Federal Government's White Paper on Tax Reform published in 1969 contained wide-sweeping proposals for change in our Federal tax system. Many areas of taxation were affected; several areas however were specifically deferred for later consideration. One of these was the tax treatment of retirement income plans. The Federal Government has been conspicuously silent on this

subject. The Chamber believes that the government should now be reviewing the tax treatment of retirement income plans. The Chamber would welcome the opportunity to comment on proposals emanating from such a review before the proposals become law. In the interim it believes the following comments can usefully be made now.

Registration of Plans

At present there are a number of different types of plans which can be registered for special income tax treatment and wide variety of complex rules governing the tax treatment of each plan, their contributors and beneficiaries. From a structural point of view it might be desirable to deal with only a single type of plan. As a practical matter, given the present variety of plans and the variations and individual circumstances, a single type of plan would not be appropriate in every case. As a result, the Income Tax Act should continue to provide for a variety of different plans.

Limits on Deductibility of Contributions

The Chamber believes that there are a number of general changes which could be made to improve the conditions for deductibility of contributions to a number of the statutorially approved plans.

The Chamber believes that there should be greater standardization of the limits for deductibility of contributions to the various plans. In particular the Chamber is concerned about the position of taxpayers who have been unable to fund retirement income plans in their early years. This may be the case where individuals have been employed by companies which have had no pension plans, where individuals have required all their funds to finance the growth of their own business, where individuals have left companies with plans prior to acquiring vested rights in the plans or simply because they have failed to make registration retirement savings plans contributions in their early years. To correct this inequity, the Chamber believes that some system of lifetime contribution limits should be considered for all retirement income plans provided for in the Income Tax Act. In particular a more general system should be introduced to make it possible for an individual who contributes to a registered retirement savings plans to make catch-up payments which would be in addition to the normal annual contribution in a manner similar to that for members of registered pension plans. The latter can make up past service shortages by their own personal contributions or benefit from lump sum payments to their pension plans by their employer to fund actuarial deficiencies in funding from prior years.

Taxation of Retirement Plans

The Chamber recommends continuation of the present rules for taxation of retirement income plans while funds are being accumulated. In particular, these plans should continue to be exempt from taxation and subject only to special taxes required to impose reasonable limits on the investments made by such plans and to provide penalties in the event that excess contributions are made.

It believes however, that these rules should be the same for all retirement plans and that compliance with these rules would be facilitated if they were set out fully in one section of the act rather than being sprinkled around among a number of Parts of the Act as at present.

Taxation of Benefits Withdrawn from Plans

1. Where the benefits are being received in the form of an annuity the Chamber believes that the recipient taxpayer should have the right to have the amount taxed in whole or in part either in his own hands or those of his spouse, if any.

2. Taxpayers should not be limited to life annuities as the only method of receiving benefits. Where lump sum amounts are taxed these can probably be taxed as regular income subject to the right to a tax-free transfer of funds from one plan to another. However, each taxpayer should have the right to receive his benefits in the form of fixed term annuities under prescribed conditions or other alternatives such as the present RRIF plan.

3. The Chamber believes it would be appropriate to provide some special rules for retirement income of R.R.S.P.'s corresponding to capital gains realized or dividends received from taxable Canadian Corporations along the lines proposed for these plans in the December 11th, 1979 budget.

ADMINISTRATION OF THE INCOME TAX ACT

We appreciate that one must expect a degree of red tape in any large bureaucracy. But significant improvements can and should be made in administrative procedures to reduce the frustration that taxpayers experience in dealing with the Department of National Revenue.

The introduction of a simplified individual tax return in 1979 is clearly a step in the right direction. There are a number of other areas which we feel require attention now.

Notices of assessment and reassessment should show the name and phone number of an individual in the Department responsible for dealing with the taxpayer on queries or disputes. The taxpayer should be able to be confident that matters of a routine nature can be handled by this specified individual. Too often taxpayers (we are referring particularly to individual taxpayers) cannot obtain a satisfactory and prompt response to their queries. They experience frustration when their contact at the Department blames the problem of the delay on "the computer" or departmental procedures, or some other section within the Department.

The Department often takes too long to issue a revised assessment in response to a taxpayer's request. It becomes necessary for the taxpayer to file a notice of objection to maintain his rights when the delay goes beyond the 90-day limit.

There is still room for improvement in providing explanations on assessments of tax and interest. The reasons given for the reassessment are often unclear. The computation of the revised tax or the interest penalty is often not provided. Frequently, when taxpayers take the trouble to check interest calculations, they find errors in the Department's calculations.

Tax returns preparers and tax advisors sometimes experience difficulty in being permitted to deal with the Department on behalf of their clients. We appreciate the need to protect the confidentiality of tax return information. These considerations could be resolved by providing a space on the tax return where the taxpayer could, at his option, enter the name and telephone number of an authorized agent, thereby providing him the authority to discuss the taxpayer's return with the Department.

Disputes between taxpayers and assessors may generally be appealed to higher levels within the Department. This process makes it possible for disputes to be resolved without necessarily resorting to the courts. However, the appeal process loses effectiveness if the reviewer does not take a reasonable independent look at the issue. We find that particularly in dealing with valuation disputes, there is a tendency by reviewers to rely unduly upon the position initially developed by the assessor.

We have become aware that the Taxation Division of the Department is disputing the transfer price of certain imports even though the Excise Division accepted the price of those same imports. Taxpayers should not be subjected to conflicting positions taken by the same government department. At the very least, when a valuation is finally settled, it should be acceptable for both purposes.

Income Averaging Annuity Purchases

March 31st of the following year would seem to be a more appropriate date than sixty days after the taxation year as the final date for purchasing an income averaging annuity. Most individual taxpayers will require substantial time to gather the necessary information to enable them to decide whether it would be advantageous to purchase an income averaging annuity. To ensure that this later purchase date does not permit an additional deferral, the legislation could be amended to provide that the income averaging annuity would provide for an initial payment no later than December 31st of the year following the taxation year in which a deduction is claimed.

The Chamber recommends that the income averaging provisions be amended to permit the transfer of funds from one income averaging annuity to another without a tax penalty. There seems to be no persuasive reason why a taxpayer should be locked into an annuity, which may run for fifteen years and bear a relatively low rate of interest, rather than being permitted to roll the amount of the annuity over into another, higher yielding annuity. The desirability of such flexibility and fairness is manifestly apparent during times of great economic uncertainty and historically high and escalating interest rates, such as have been experienced in recent months. So long as the other terms of the annuity remain substantially unchanged -- apart from the yield -- in our view, there is no taxable event warranting imposition of tax at the time of the transfer.

COMMODITY TAXATION

Excise Tax Act

In previous pre-budget submissions, the Chamber recommended a number of changes to the Excise Tax Act. It is gratifying to note that several of our recommendations have been implemented.

We have forwarded our detailed comments on both the discussion paper dated June 23, 1975 (response dated December 1975) and the Report of the Commodity Tax Review Group dated June 27, 1977 (response to the Standing Committee on Finance, Trade and Economic Affairs dated August 16, 1978). The Chamber recognizes the need for changes to the Excise Tax Act in order to provide a more equitable tax base. However, we are not at this time, prepared to support tax reform to the wholesale level as recommended by the Commodity Tax Review Group.

We believe that there is a necessity to further analyze and study the tax shift which would occur if tax reform to the wholesale level were adopted. Some attempt should be made to illustrate the tax shift between manufacturers, distributors, wholesalers, retailers and consumers and to clearly define who must pay the tax. As well, should tax reform take place, great care would have to be taken setting the rate so as not to impose a greater overall sales tax burden on Canadian consumers than at the present time.

In connection with the need to measure the effect of new tax reform measures, some advanced knowledge as to the proposed administrative procedures which must be adopted by both the taxpayer and the government in conjunction with revised legislation would be helpful. It is our view that many of the existing administrative problems would not be eliminated by the tax reform measures included in the Report of the Commodity Tax Review Group. In particular, we see specific administrative problems arising from the treatment of transportation costs, the establishment of new national values, and the imposition of a surtax on certain retail organizations.

Consequently, while we wish to encourage the Department with regard to its review of the Excise Tax Act, and its endeavours to obtain a more equitable federal sales tax, the Chamber would appreciate the opportunity of discussing any major changes to the Excise Tax Act prior to the introduction of legislation.

In the event that sales tax reform may not occur during the next year, we recommend during the interim period the Excise Tax Act be amended to provide for the following:

1. A four-year statutory limit on audits.

2. Provision for the payment of interest on refunds of federal sales tax overpayment.

3. The definition of "sale price" be broadened to incorporate or make provision for certain deductions which are now permitted by administrative policy.

4. Provision for an appeal procedure for the resolution of disputes by an independent body.

The March 31st, 1977 federal budget extended the period during which application for refund may be made from two to four years. There are still a large number of audits performed by Customs and Excise of the Department of National Revenue which cover a period greater than four years. If a liability error or overpayment has been made in favour of the Department, there is no legal recourse for recovery. On the other hand, if an assessment results, it is generally too late to take corrective action retroactively to eliminate the problem.

In addition, the taxpayer incurs penalty interest which in some situations is unfair. If audits were conducted every two or three years, then there would be very little reason to complain. However, because some taxpayers are not audited for periods up to five, six and sometimes seven years, a major problem may result. To ensure equal treatment to all taxpayers, we recommend a four year statutory limitation on audits conducted for sales and excise tax purposes.

At the present time, the taxpayer incurs penalty interest on underpayments of federal sales tax. However, where overpayments of federal sales tax occur, which require the taxpayer to file for refund, there is no provision for the payment of interest. We feel that the Department should seriously consider the payment of interest on such overpayments of federal sales tax.

Recommendation number three mentioned above deals with the revised definition of "sale price". This recommendation was also proposed by the Commodity Tax Review Group. It is the Chamber's view that the definition of sale price should not be delayed until tax reform measures are adopted. In fact, transportation and installation costs are, within certain limitations, presently deductible from sale price by administrative policy without statutory authority. The Chamber encourages an early change in the Excise Tax Act to reflect the revised definition of "sale price" to include provision for the deduction of costs such as transportation, erection or installation, interest charges, and discounts from the value subject to federal sales and excise tax.

In previous pre-budget submissions, the Chamber recommended that the Excise Tax Act provide for informal appeal procedures so that a taxpayer can, and has the right to, contest an assessment arising from an audit, value or ruling. The Commodity Tax Review Group recommended similar legislation. We continue to support this proposal and would encourage its enactment at an early date.

Customs Act

The existing Customs Act is in need of a major revision as it is one of the oldest and most out-dated statutes currently in use. It has been amended numerous times over the years but never entirely re-drafted.

It is our understanding that the Department of National Revenue is proposing to re-write the Customs Act to eliminate the obsolete and often inconsistent provisions of the old act and to restructure it in a more logical sequence. This revision should also provide greater flexibility to accommodate modern transportation and communication systems. As well, the revision should bring the legislation in line with general business practises, including the collection of revenues.

We agree with the Department of National Revenue's initiative and encourage the drafting of new legislation at an early date. We would also appreciate the opportunity to discuss this draft legislation with the Department prior to its introduction.

THE CANADIAN CHAMBER OF COMMERCE

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